Supreme Court, U.S.
FILED

No. 99- 99 6 85 OCT 21 1999

OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1999

MICHAEL P. KENT AND MICHELLE KENT,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

STEVEN J. BROOKS
JOHN FOSKETT
Counsel of Record
DEUTSCH WILLIAMS BROOKS
DERENSIS HOLLAND AND DRACHMAN, P.C.
99 Summer Street
Boston, Massachusetts 02110
(617) 951-2300

Counsel for the Petitioners

BATEMAN & SLADE, INC. BOSTON, MASSACHUSETTS

3818

QUESTION PRESENTED

Whether the gambling losses of a full-time, professional gambler who realizes income from no other source are fully deductible under § 162(a) of the Internal Revenue Code, as they would be in any other trade or business, or instead may be deducted only to the extent of gambling winnings under § 165(d)?

TABLE OF CONTENTS

QUESTION PRESENTED i

OPINIONS BELOW 1

TABLE OF AUTHORITIES iii

JURISDICTION 2

STATUTORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 2

A. Facts 2

B. Course of Proceedings 4

I. The Ninth Circuit's Discriminatory Treatment of Professional Gambling Businesses is in Conflict With *Groetzinger's* Recognition That There is no Warrant in The Internal Revenue Code For Such a Distinction 8

II. The Ninth Circuit's Use of The "Specific-General" Rule of Statutory Construction in The Absence of an Irreconcilable Conflict Between § 162(a) and § 165(d) Violates This Court's Requirement of Such a Conflict 11

III. The Ninth Circuit's Analysis Ignores The Legislative Purpose Behind Enactment of The Predecessor to § 165(d),Which Was Intended to Combat an Evil Practiced by The Occasional, Non-Professional, Hobbyist Gambler 13

CONCLUSION 18

APPENDIX ..... *follows conclusion*

TABLE OF AUTHORITIES

CASES:

Boyd v. United States, 762 F.2d 1369 (CA 9 1985) 5, 6, 7n, 10, 12

Commissioner v. Groetzinger, 480 U.S. 23 (1987) ..... *passim*

Detweiler v. Pena, 38 F.3d 591 (CA DC 1994) 12

Edmond v. United States, 520 U.S. 651 (1997) 12

Estate of Todisco v. Commissioner, 757 F.2d 1 (CA 1 1985) 10n

Humphrey v. Commissioner, 162 F.2d 853 (CA 5), *cert. denied*, 332 U.S. 817 (1947) 10n

Kochevar v. Commissioner, 70 T.C.M. (CCH) 1627 (1995) 7n, 11n

Nitzberg v. Commissioner, 580 F.2d 357 (CA 9 1985) ..... *passim*

Skeeles v. United States, 95 F.Supp. 242 (Ct. Cl.), *cert. denied*, 341 U.S. 948 (1951) 10n, 17n

United States v. Doe, 465 U.S. 605 (1984) 7n

Valenti v. Commissioner, 68 T.C.M. (CCH) 838 (1994) 7n, 11n, 12n

Watt v. State of Alaska, 451 U.S. 259 (1981) 12

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES

Fifth Amendment, United States Constitution 5

26 U.S.C. § 162(1) 8
26 U.S.C. § 162(a) ..... *passim*
26 U.S.C. § 165(d) ..... *passim*
26 U.S.C. § 172(a) 9, 9n
28 U.S.C. § 1254(1) 2

Fed.R.App.Pro. Rule 30 ..... 3n

Revenue Act of 1934, ch. 277, 48 Stat. 680 (1934) 13, 13n, 15, 15n

Treas. Reg. § 1.165-10 ..... 13n

MISCELLANEOUS:

H. Rep. 704 (73d Cong., 2d Sess.) 14

S. Rep. 558 (73d Cong., 2d Sess.) 14

1 United States Senate, 73d Cong. 2d Sess., on H.R. 7835, Part I, March 6, 1934 (Unrevised (1934) 16

"The Business of Betting; Proposals for Reforming the Taxation of Business Gamblers", 38 *Tax Lawyer* 737 (1985) 15

APPENDIX
TABLE OF CONTENTS

APPENDIX A

Opinion of the Court of Appeals (unreported) 1a

APPENDIX B

Decision of the Court of Appeals denying the petition for rehearing and rejecting the petition for rehearing en banc 4a

APPENDIX C

Opinion of the District Court (unreported) 6a

No. 99-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1999

MICHAEL P. KENT AND MICHELLE KENT,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Petitioners Michael P. Kent and Michelle Kent respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals [App., *infra* 1a-3a] is referenced in the table at 185 F.3d 867, but is unreported.

The decision of the Court of Appeals denying the petition for rehearing and rejecting the petition for rehearing en banc [App., *infra* 4a-5a] is unreported. The opinion of the District Court [App., *infra* 6a-14a] is unreported.

JURISDICTION

The Court of Appeals entered its judgment on May 26, 1999.

A timely petition for rehearing and petition for rehearing en banc was filed on June 28, 1999 and was denied on July 29, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 162(a) of the Internal Revenue Code, 26 U.S.C. § 162(a), provides, in pertinent part, that "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, . . .".

Section 165(d) of the Internal Revenue Code, 26 U.S.C. § 165(d), provides that "[l]osses from wagering transactions shall be allowed only to the extent of gains from such transactions."

STATEMENT OF THE CASE

A. *Facts*

The facts were undisputed in the District Court. MJM is a subchapter "S" corporation whose profits and losses pass

through to its shareholders [E.R. 53].[1] Petitioner Michael Kent is a 54% shareholder, and petitioners recognize 54% of MJM's earnings on their tax returns [E.R. 54]. Since its formation in 1988, MJM has been engaged full-time in the business of sports gambling, using a proprietary computer program designed to predict the probable outcome of professional and college football games, as well as of college basketball games [E.R. 54]. Comparing the program's results to the betting "lines" provided by licensed casinos in Las Vegas, MJM places bets at those casinos. [E.R. 54].[2] MJM engages solely in this business and does so to make a profit [E.R. 54]. Petitioner Michael Kent devotes his full time to MJM, which is his only source of earned income [E.R. 54]. MJM functions as a corporation, maintaining a board of directors, honoring in all respects the corporate form, arranging for its financial books to be maintained by a certified public accountant, and keeping records of all of its betting transactions [E.R. 54].

On their 1990 federal income tax return, petitioners recognized a loss due to a net loss from MJM's operations, while, on their amended 1987 return, they carried back their 1990 loss from MJM [E.R. 111]. In 1995, the Internal Revenue Service ("IRS") conducted an audit of petitioners' 1990 tax year and disallowed the loss which was carried back, assessing additional taxes and interest of $71,673 and $17,758 for 1987 and $16,701 and $8,400 for 1990 [E.R. 111]. Peti-

---

[1] References designated "E.R." are to the "excerpts of record" which is required to be filed in the Court of Appeals pursuant to its Local Rules in lieu of the "appendix" referred to in Fed.R.App.Pro. 30.

[2] There is no dispute that MJM's business generates substantial revenue and work activity for the casinos at which its bets are made.

tioners paid the assessments and made timely claim for a refund, but the IRS never responded [E.R. 111-112]. The net operating loss for MJM in 1990 reflected almost entirely losses incurred as a result of bets it placed, and MJM's only source of revenue is the profit it earns from bets [E.R. 55-56]. If MJM's net operating losses cannot be deducted as ordinary business losses which can be carried over or carried backward, the business will be severely disadvantaged, because it could be forced to suspend operations before the end of a given tax year to avoid a loss which cannot be used to offset income [E.R. 56].

B. *Course of Proceedings*

Petitioners filed their complaint in the District Court on December 31, 1996. The complaint made material factual allegations consistent with the facts set forth above, and sought refunds of the assessments paid pursuant to section 162(a) of the Internal Revenue Code because MJM is exclusively in the "trade or business" of gambling. [E.R. 1-6]. The Government filed an answer denying the material allegations [E.R. 43-46]. Thereafter, the parties filed cross motions for summary judgment [E.R. 49-58, 59-101, 108-09].

After a hearing, the District Court issued a memorandum order denying petitioners' motion and granting the Government's cross motion [App., *infra* 6a-14a]. In its memorandum order, the District Court characterized the dispute as whether the loss from MJM's operations is a loss from a trade or business which may be treated in accordance with § 162(a) or, instead, falls under § 165(d) such that it can only be deducted to the extent of gains from wagering transactions in that tax year [App., *infra* 9a]. The court first noted that the question has been answered favorably to the Government

in two earlier decisions by the Court of Appeals for the Ninth Circuit, *Boyd v. United States*, 762 F.2d 1369, 1372-73 (CA 9 1985) and *Nitzberg v. Commissioner*, 580 F.2d 357, 358 (CA 9 1978) [App., *infra* 9a]. The court rejected petitioners' argument that the legislative history of § 165(d) and its predecessor shows that it was intended to address the practices of occasional gamblers, finding the legislative history "unclear" [App., *infra* 10a-11a]. Next, the court applied a general rule of statutory construction, holding that § 165(d), which it characterized as the narrower provision, controls the more "general", § 162(a) [App., *infra* 12a]. The court then dismissed petitioners' assertion that the 1987 decision of this Court in *Commissioner v. Groetzinger*, 480 U.S. 23 (1987) requires a different conclusion because of its recognition that professional gambling is an acceptable trade or business like any other for tax purposes. The District Court rejected the *Groetzinger* argument because it found that the lower court decisions holding that § 165(d) applies to professional gamblers did not turn on whether the activity was deemed acceptable [App., *infra* 12a]. Finally, the court rejected petitioners' contention that the application of § 165(d) to their business violates the Fifth Amendment's Due Process Clause requirement that the Government's classification of their business have a rational basis. The court concluded that the Government's obligation is satisfied by "[p]ublic opposition to gambling as morally wrong" and that the possible resulting destruction of such business would merely prove the law's rationality by "discouraging a morally repugnant activity" [App., *infra* 13a-14a].[3] The District Court therefore

---

[3] This constitutional issue was not pursued in the Court of Appeals and is not raised here.

entered judgment against petitioners and in favor of the Government [E.R. 121].

The Court of Appeals affirmed the District Court's ruling, holding that the earlier Ninth Circuit decisions in *Nitzberg* and *Boyd* "are dispositive and clearly hold that § 165(d) limits the deduction of gambling losses even of those who gamble professionally." [App., *infra* 3a]. The court acknowledged, however, that this Court's decision in *Groetzinger* "casts some doubt on the continued vitality of the reasoning of *Nitzberg* and *Boyd*". [App., *infra* 3a]. But because *Groetzinger* "did not overrule those decisions", the Court of Appeals deemed itself constrained by the rule that "a three-judge panel . . . is bound by [Ninth Circuit] precedents." [App., *infra* 3a]. Having conceded that *Nitzberg* and *Boyd* may have been vitiated by *Groetzinger*, the court concluded that "[i]f [they] are not to be followed any longer, the court sitting en banc must overrule them. [citation omitted]" [App., *infra* 3a].

The panel denied the petition for rehearing. The petition for rehearing en banc was rejected although two of the three members of the panel recommended en banc consideration [App., *infra* 5a].[4]

REASONS FOR GRANTING THE PETITION

The Court of Appeals conceded that Ninth Circuit law is in apparent conflict with the reasoning underlying *Groetzinger*. [App., *infra* 3a]. Although the court therefore ac-

---

[4] In the Court of Appeals, petitioners' appeal was consolidated with that brought by the other shareholder in MJM and his spouse, who had filed a similar lawsuit and obtained a similar result before another judge of the District Court. That case is not the subject of the instant petition.

knowledged this essential flaw in its treatment of petitioners' claim, it deemed itself confined by the judicially-developed rule that a panel cannot correct erroneous circuit precedent except in unusual circumstances not found here.[5] An "apparent conflict" such as this case presents is sufficient grounds for granting certiorari. *United States v. Doe*, 465 U.S. 605, 610 (1984).

Moreover, the petition raises an important question with respect to administration of the federal income tax laws. While the revenue impact of this question is difficult to determine, the erroneous treatment accorded a class of federal taxpayers merits consideration by this Court. This is particularly so because the Ninth Circuit includes within its jurisdiction the State of Nevada, which has for many years been, and even with the proliferation of authorized and government-supported betting nationwide remains, the recognized center of lawful wagering in the United States. Nevada therefore is likely to count among its residents a disproportionate number of taxpayers affected by Ninth Circuit rulings, such as petitioners.[6]

---

[5] Significantly, one of the panel members who discerned this conflict also sat on the panel which decided *Boyd* in 1985.

[6] This is not to say that *Nitzberg* and *Boyd* are without influence in other jurisdictions. See, e.g., *Valenti v. Commissioner*, 68 T.C.M. (CCH) 838, 839-40 (1994) and *Kochevar v. Commissioner*, 70 T.C.M. (CCH) 1627, 1629 (1995).

I. The Ninth Circuit's Discriminatory Treatment of Professional Gambling Businesses is in Conflict With *Groetzinger's* Recognition That There is no Warrant in The Internal Revenue Code For Such a Distinction.

In *Groetzinger,* this Court was asked to resolve a question related, but not identical, to that presented here, i.e., whether a "full-time gambler who makes wagers for his own account is engaged in a 'trade or business' within the meaning of §§ 162(a) and 62(1) [of the Internal Revenue Code]." *Commissioner v. Groetzinger*, 480 U.S. at 24. Technically, the issue presented in *Groetzinger* concerned exclusion of the taxpayer's deduction for gambling losses as "attributable to a trade or business" and therefore not includable as an item of tax preference in calculating his "alternative minimum tax" under IRS regulations then in effect. *Id.* at 25-26. Because the taxpayer's wagering activities were "pursued full time, in good faith, and with regularity, to the production of income for a livelihood", the Court held that he was in fact engaged in a "trade or business" within the meaning of the Internal Revenue Code. *Id.* at 35-36.

Pertinent to the petition at bar, in *Groetzinger* this Court articulated the principle which underlies petitioners' request that it grant the writ. The Court stated that in the case of a full-time, professional wagerer,

> [i]t would seem that basic concepts of fairness (if there be much of that in the income tax law) demand that his activity be regarded as a trade or business just as any other readily accepted activity, such as being a retail store

> proprietor or, to come closer categorically, as being a casino operator or as being an active trader on the exchanges. *Commissioner v. Groetzinger*, 480 U.S. at 33.

The Court sharply criticized decisions in the lower courts which treated professional gamblers differently from other professions under the "trade or business" test, because those cases "in effect were creating a special class of, and with special rules for, the full-time gambler." *Commissioner v. Groetzinger*, 480 U.S. at 34 n.14. The Court rejected this judicially-imposed discrimination, stating bluntly "[w]e find no warrant for this in the Code." *Id.*

The Ninth Circuit's interpretation of § 162(a) and § 165(d), developed before *Groetzinger* in *Nitzberg* and *Boyd* and applied to petitioners' case notwithstanding the panel's reservations about its continuing validity, establishes precisely the distinction between lawful wagering businesses and other commercial ventures which was eschewed by this Court.

Application of net operating losses to other tax years is a natural concomitant of the § 162(a) deduction, under § 172(a).[7] The life of a business spans many tax reporting years. Profits achieved in one year are related to business activities, including losses and expenses, concluded in other years. The ability to carry over business losses mitigates the arbitrariness which is inherent in tax reporting based on a finite "tax year". It ensures that the tax burden of a business

---

[7] 26 U.S.C. § 172(a) provides that "[t]here shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year."

more accurately reflects its actual long-term financial performance. If deprived of the right granted by § 162(a) to "*any* trade or business" [emphasis added], a business inevitably shoulders a disproportionate tax burden in relation to other enterprises. Yet *Nitzberg* and *Boyd* establish a solitary exception to this basic rule of tax equity.

Petitioners' MJM business provides a graphic example. It engages full-time in wagering, utilizing a sophisticated computer program developed after years of entrepreneurial work. MJM honors the corporate form religiously, and keeps extensive, accurate books and records maintained by a certified public accountant. It places wagers only at licensed casinos, and complies fully with all tax reporting obligations. The gross disparity between MJM's tax treatment and that of other businesses, operated in precisely the same manner with the same ultimate objective, is the very type of discrimination which *Groetzinger* rejected, and this Court should correct the Ninth Circuit's continued adherence to pre-*Groetzinger* precedent.[8]

---

[8] The other lower court decisions which have applied § 165(d) to professional gamblers for the most part antedate *Groetzinger*. *See, e.g.*, *Humphrey v. Commissioner*, 162 F.2d 853, 855 (CA 5), *cert. denied*, 332 U.S. 817 (1947); *Skeeles v. United States*, 95 F.Supp. 242, 246-47 (Ct.Cl.), *cert. denied*, 341 U.S. 948 (1951); *Estate of Todisco v. Commissioner*, 757 F.2d 1, 7 n.4 (CA 1 1985). *Skeeles* is of note because the Ninth Circuit relied on it in both *Nitzberg* and *Boyd*. *Nitzberg v. Commissioner*, 580 F.2d at 358; *Boyd v. United States*, 762 F.2d at 1372-73. *Skeeles*, decided nearly a half century ago, turned largely on the court's perception that gambling is "immoral[]", referring to its "evils", "trickery and deception", and describing the professional gambler as one "who undertakes, without work, to wring a living from the wages of others." *Skeeles v. United States*, 95 F.Supp. At 242-44. In *Groetzinger*, this Court implicitly rejected tax treatment of gamblers which is based on outdated notions of their morality. *Commissioner v. Groetzinger*, 480

II. The Ninth Circuit's Use of The "Specific-General" Rule of Statutory Construction in The Absence of an Irreconcilable Conflict Between § 162(a) and § 165(d) Violates This Court's Requirement of Such a Conflict.

In neither *Nitzberg* nor *Boyd* did the Ninth Circuit find express language in the Code to support discrimination between professional wagering businesses and other business ventures. Instead, recognizing that professional gambling losses are at the same time an expense under § 162(a) and a loss from wagering under § 165(d), both decisions resorted to a rule of statutory construction which defers to the more "specific" of two statutes in the event of a conflict. In both cases, therefore, the court applied § 165(d) to decide the question because, by referring to losses from "wagering transactions", it is more "specific" than § 162(a), which refers to expenses from any "trade or business". *Nitzberg v. Commissioner*, 762 F.2d at 1372-73; *Boyd v. United States*, 580 F2d at 358. The analysis in these cases is flawed because they not only result in the type of disparate tax treatment condemned in *Groetzinger,* but because they also employ a rule of statutory interpretation in contravention of the strictures imposed by this Court on the use of such rules.

U.S. at 32 n.11 and 33. In only one of two post-*Groetzinger* decisions confronting this question has the Tax Court dealt with its applicability. In that case, the Tax Court, citing *Nitzberg* and *Boyd*, merely stated that *Groetzinger* "did not at any point consider the interplay" between § 162(a) and § 165(d). *Valenti v. Commissioner*, 68 T.C.M. (CCH) at 840. The other case simply ignored *Groetzinger*. *Kochevar v. Commissioner*, 70 T.C.M. (CCH) at 1629.

In *Watt v. State of Alaska*, 451 U.S. 259, 266 (1981), this Court held that it would not apply the sister rule of construction that the more recent of two enactments controls *unless* the two compared provisions are truly "irreconcilable." *See Edmond v. United States*, 520 U.S. 651, 656-58 (1997) (undertaking a detailed inquiry to determine whether two statutes "conflict[]" as a prerequisite to application of the "specific-general" rule); *Detweiler v. Pena*, 38 F.3d 591, 594 (CA DC 1994) (citing *Watt* to require an "'irreconcilabl[e]'" conflict before employing either the "specific-general" rule or its "more recent-earlier" analogue). In *Nitzberg*, however, the Ninth Circuit failed even to articulate a conflict, let alone determine whether it was "irreconcilable", but simply called on the rule of construction to interpret the statutes. *Nitzberg v. Commissioner*, 580 F.2d at 358. The panel in *Boyd* at least identified a "conflict" but, again, failed to assess whether it satisfied the additional requirement of irreconcilability. *Boyd v. United States,* 762 F.2d at 1372-73.

In fact, the putative conflict between § 162(a) and § 165(d) evaporates upon a fair reading of the two together. Section 165(d) makes no reference to "trade or business" or to the "professional" or "full-time" gambler. Section 162(a) refers to all "trade[s] or business[es]" without qualification. An interpretation which says that § 165(d) therefore applies only to the casual or hobbyist gambler, while § 162(a) applies to those whose "trade or business" is gambling, is reasonable and harmonizes the enactments without employing an inapt rule of construction.[9,10]

---

[9] In fact, in a recent memorandum decision, the Tax Court, citing, *inter alia*, *Nitzberg*, was able to characterize the conflict only as "apparent", but still resorted to the "specific-general" rule of construction. *Valenti v. Commissioner*, 68 T.C.M. (CCH) at 839.

III. The Ninth Circuit's Analysis Ignores The Legislative Purpose Behind Enactment of The Predecessor to § 165(d), Which Was Intended to Combat an Evil Practiced by The Occasional, Non-Professional, Hobbyist Gambler.

The approach urged by petitioners is in accord with the legislative purpose behind § 165(d), while that used by the Ninth Circuit flatly ignores that purpose. What is now § 165(d) was first enacted as § 23(g) of the Revenue Act of 1934.[11] Section 23(g) contained the same language as does § 165(d), providing that "[l]osses from wagering transactions shall be allowed only to the extent of the gains from such transactions."[12]

The restriction on wagering losses in original § 23(g) of the 1934 act was intended to bar the fabrication of losses to reduce unrelated income. This legislative purpose is stated clearly in the Report of the House Committee on Ways and Means:

> Existing law does not limit the deduction of losses from wagering transactions where such transactions are legal. Under the interpretation

---

[10] Fairly comprised within petitioners' argument is the correctness of the Ninth Circuit's conclusion that § 165(d) clearly is the more "specific". It can just as easily be said that § 162(a), which is the only one of the two provisions referring to "trade or business", meets that criterion.

[11] Revenue Act of 1934, ch. 277, 48 Stat. 680 (1934).

[12] *See also* Treas. Reg. § 1.165-10.

> of the courts, illegal gambling losses can only be taken to the extent of the gains from such transactions. A similar limitation on losses from legalized gambling is provided in the bill. Under the present law many taxpayers take deductions for gambling losses but fail to report gambling gains. *This limitation will force taxpayers to report their gambling gains if they desire to deduct their gambling losses.* H. Rep. 704 (73d Cong., 2d Sess.) at 22 [emphasis added].

The same language appeared in the Report of the Senate Committee on Finance. *See* S. Rep. 558 (73d Cong., 2d Sess.) at 25.

Congress therefore intended the new law to curtail a common deception: "many taxpayers take deductions for gambling losses but fail to report gambling gains". The only taxpayers who stood to benefit from reporting gambling losses without reporting gambling gains were those who had *non-gambling* income against which such gambling losses could be applied. By definition, those persons were not engaged exclusively in gambling as their sole source of regular income, and they were therefore not in the trade or business of gambling. Instead, they were sporadic gamblers who offset their other income with the results of their losing wagers or were scavengers who claimed and applied the losses of other gamblers against their own income. Under the new law, taxpayers could no longer transform gambling losses into a tax advantage by concealing their gambling gains. Nor could they so easily cheat the system by collecting strangers' dis-

carded betting slips or receipts claiming others' losing bets as their own, and reporting no gambling income.[13]

The clear congressional purpose which motivated enactment of § 23(g), to discourage the reporting of losses without gains, has no application to full-time, carefully-managed, incorporated gambling businesses such as MJM whose sole source of revenue is its wagering transactions. It is problematic whether there even was reason in 1934 for Congress to be concerned with gambling as a "trade or business". In the early part of this century, "gambling was predominantly illegal and underground". Note, "The Business of Betting; Proposals for Reforming the Taxation of Business Gamblers", 38 *Tax Lawyer* 737, 773 (1985). Half a century later and more, as this Court recognized in *Groetzinger*, lawful, aboveboard gambling is a dominant feature of the nation's recreation, with state-run lotteries around the country, licensed casino resorts in many states, and almost-universal sports wagering. *Commissioner v. Groetzinger*, 480 U.S. at 32 n.11.

The only evidence that Congress considered professional gamblers at all in 1934 leaves open to question whether it intended § 23(g) to apply. During hearings on the bill, the Senate Committee on Finance heard from Dr. Roswell Magill, Assistant to the Secretary of the Treasury, who testified as follows:

---

[13] In *Groetzinger*, the Court adverted to § 23(g), noting that it "closed the door on suspected abuses", but was not asked to, and did not, decide the applicability of § 165(d) to the professional gambler in lieu of § 162(a). *Commissioner v. Groetzinger*, 480 U.S. at 32. The dissenting opinion assumed its applicability without analyzing the § 162(a) issue. *Id.* at 37 (White, J., dissenting).

> Dr. Magill: The next paragraph [§23(g)] is a new provision which is self-explanatory, that losses from wagering transactions are to be allowed only to the extent of gains from such transactions.
>
> The Chairman: Explain that paragraph.
>
> Dr. Magill: . . . The line which Treasury draws is, I believe, whether or not the gambling transaction was legal in the state in which it occurred; and they have gone into a good deal of dissertation as to whether it is legal gambling.
>
> Sen. Reed: Also, haven't they discussed the question of whether that is the taxpayer's regular business?
>
> Dr. Magill: You wouldn't need to in this connection, because he could get the deduction as a loss, if the transaction was entered into for profit, in the event that the transaction was legal. Hearings before the Committee on Finance, 1 United States Senate, 73d Cong., 2d Sess., on H.R. 7835, Part I, March 6, 1934 (Unrevised 1934) at 32-33.

Dr. Magill's comment did not identify the mechanism by which a professional gambler might "get the deduction as a

loss," and gave no indication that the loss would be limited to the amount of winnings.[14]

The Ninth Circuit's rule, applied to traditional corporate enterprises such as MJM which present no prospect of the evil at which the deduction limit is directed, is erroneous and should be corrected to fit the legislative purpose.

---

[14] In fact, the only reported decision addressing this legislative history found it inconclusive. *Skeeles v. United States*, 95 F.Supp. 242, 247 (Ct. Cl.), *cert. denied* 341 U.S. 948 (1951).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

STEVEN J. BROOKS
JOHN FOSKETT
Counsel of Record
DEUTSCH WILLIAMS BROOKS
DERENSIS HOLLAND AND DRACHMAN, P.C.
99 Summer Street
Boston, Massachusetts 02110
(617) 951-2300

October, 1999

APPENDIX A

NOT FOR PUBLICATION

UNITED STATE COURT OF APPEALS
FOR THE NINTH CIRCUIT

MICHAEL P. KENT AND MICHELLE KENT,	) No. 98-15921
	) D.C. CV-96-01205-PMP
Plaintiffs-Appellants,	)
	) MEMORANDUM
v.	)
	)
UNITED STATES OF AMERICA	)
	)
	)
Defendant-Appellee.	)

Appeal from the United States District Court
for the District of Nevada
Philip M. Pro, District Judge, Presiding

Argued and Submitted May 14, 1999
San Francisco, California

JOHN C. KENT, and DIANE L. KENT,	) No. 98-16431
Plaintiffs-Appellants,	) D.C. CV-96-1083-LDG
v.	)
UNITED STATES OF AMERICA,	)
Defendant-Appellee.	)

This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Ninth Circuit Rule 36-3.

Appeal from the United States District Court
for the District of Nevada
Lloyd D. George, District Judge, Presiding

Argued and Submitted May 14, 1999
San Franciso, California

Before: B. FLETCHER and SILVERMAN, Circuit Judges, and Walter,** District Judge.

** Honorable Donald E. Walter, District Judge for the Western District of Louisiana, sitting by designation.

At issue in this appeal is whether professional gamblers, who indisputably engage in sports wagering as a trade or business, may deduct their losses and other expenses, and take loss carry-backs, just as any other taxpayers engaged in a trade or business under 26 U.S.C § 162(a); or whether the limitation on gambling deductions in 26 U.S.C. § 165(d) applies even to those who gamble as a business. The district court correctly held that our decisions in *Nitzberg v. Commissioner*, 580 F.2d 357 (9th Cir. 1978) and *Boyd v. United States*, 762 F.2d 1369 (9th Cir. 1985) are dispositive and clearly hold that § 165(d) limits the deduction of gambling losses even of those who gamble professionally.

It is true that the U.S. Supreme Court's 1987 decision in *Commissioner v. Groetzinger*, 480 U.S. 23 (1987) casts some doubt on the continued vitality of the reasoning of *Nitzberg* and *Boyd*, but it did not overrule those decisions. Like the district court, a three-judge panel of this court is bound by our precedents. If *Nitzberg* and *Boyd* are not to be followed any longer, the court sitting en banc most overrule them. *See Ferrari, Alvarez, Olsen & Ottoboni v. Home Ins. Co.*, 940 F.2d 550, 557 (9th Cir. 1991). For the foregoing reasons, we affirm.

APPENDIX B

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MICHAEL P. KENT AND MICHELLE KENT,	) No. 98-15921
	) D.C. CV-96-01205-PMP
Plaintiffs-Appellants,	)
v.	)
UNITED STATES OF AMERICA	)
Defendant-Appellee.	)

JOHN C. KENT, and DIANE L. KENT,	) No. 98-16431
	) D.C. CV-96-1083-LDG
Plaintiffs-Appellants,	)
v.	)
UNITED STATES OF AMERICA,	) ORDER
Defendant-Appellee.	)

Before: B. FLETCHER and SILVERMAN, Circuit Judges, and WALTER,[1] District Judge.

The panel has voted to deny appellants' petition for rehearing. Judge Silverman votes to deny appellants' suggestion for rehearing en banc and Judge Fletcher and Judge Walter so recommend.

The full court has been advised of the petition for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

---

[1] Honorable Donald E. Walter, District Judge for the Western District of Louisiana, sitting by designation.

APPENDIX C

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

* * *

MICHAEL P. AND MICHELLE KENT,	)	
Plaintiff,	)	CV-S-96-01205-PMP
v.	)	ORDER
UNITED STATES OF AMERICA,	)	
Defendant.	)	

Presently before the Court is Michael P. and Michelle Kent's ("the Kents") Motion for Summary Judgment (#8) filed September 30, 1997. The United States of America ("United States") also filed a Motion for Summary Judgment (#9) on October 30, 1997. This Court entered an Order (#10) granting the Kents' Motion for Summary Judgment due to the United States failure to respond on October 31, 1997. On November 10, 1997, the Kents filed an Opposition to Cross-Motion of United States for Summary Judgment/Reply to Memorandum of United States in Opposition to Plaintiffs' Motion for Summary Judgment (#13). On November 13, 1997, the Court entered an Order (#15) vacating the previous Order granting Summary Judgment for the Kents. The United States filed a Cross-Motion for Summary Judgment

(#16) on November 25, 1997. Also on November 25, 1997, the United States filed an Opposition to Plaintiffs' Motion for Summary Judgment and in Support of United States' Cross-Motion for Summary Judgment (#17). On March 18, 1998, the Court conducted a hearing regarding the Cross-Motions for Summary Judgment.

I. Factual Background

Michael Kent helped found and is an owner of MJM Corporation ("MJM"), a subchapter "S" corporation. MJM's business is placing bets on various sporting events. A computer program that predicts the outcome of the sporting events and compares its prediction to the betting lines of various Las Vegas casinos. The corporation then places the bets. Running MJM is Michael Kent's sole occupation.

As a subchapter "S" corporation, MJM's profits and losses flow through to the shareholders' tax returns. Michael Kent owns 54% of MJM's stock, so the Kents recognize 54% of its earnings on their joint tax return. On their 1987 tax return, the Kents showed a significant tax liability. On their 1990 tax return, the Kents recognized a loss due to a net loss from MJM's operation. The Kents filed an amended tax return for 1987 in order to carry their 1990 loss back to 1987.

In 1995, the Internal Revenue Service ("IRS") conducted an audit of the Kents' 1990 tax year, and disallowed the loss which was carried back to 1987. The IRS assessed the Kents additional taxes of $71,673 for 1987 and $16,701 for 1990. The Kents paid the additional taxes plus interest and filed a claim for a refund. The IRS has not responded to the Kents' claim. On December 31, 1996, the Kents filed a Complaint in this Court seeking a refund for their 1987 and 1990 tax years.

II. Summary Judgment Standard

Pursuant to Federal Rule of Civil Procedure 56, summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56.

The party moving for summary judgment has the initial burden of showing the absence of a genuine issue of material fact. Metro Indus., Inc. v. Sammi Corp., 82 F.3d 839, 847 (9th Cir.), cert. denied, ___ U.S. ___; 117 S. Ct. 181 (1996). If the party seeking summary judgment meets this burden, then summary judgment will be granted unless there is significant probative evidence tending to support the opponent's legal theory. First Nat'l Bank v. Cities Serv. Co., 391 U.S. 253, 290, (1968), reh'g denied, 393 U.S. 901 (1968). Once the movant's burden is met by presenting evidence which, if uncontroverted, would entitle the movant to a directed verdict at trial, the burden then shifts to the respondent to set forth specific facts demonstrating that there is a genuine issue for trial. Anderson v. Liberty Lobby, 477 U.S. 242, 250 (1986).

Parties seeking to defeat summary judgment cannot stand on their pleadings once the movant has submitted affidavits or other similar materials. Affidavits that do not affirmatively demonstrate personal knowledge are insufficient. British Airways Bd. v. Boeing Co., 585 F.2d 946, 952 (9th Cir. 1978), cert. denied, 440 U.S. 981 (1979), reh'g denied, 441 U.S. 968 (1979). Likewise, "legal memoranda and oral argument are not evidence and do not create issues of fact capable of defeating an otherwise valid motion for summary judgment." Id.

The Supreme Court cases establish that "[s]ummary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed 'to secure the just, speedy and inexpensive determination of every action.'" Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986) (quoting Fed. R. Civ. P. 1). See also Avia Group Int'l Inc. v. L.A. Gear California, Inc., 853 F.2d 1557, 1560 (Fed. Cir. 1988).

III. Discussion.

The Kents maintain that they should be allowed to recognize the loss from MJM under 26 U.S.C. § 162(a) which allows the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." The IRS states that the loss falls under 26 U.S.C. § 165(d) which limits losses from gambling to the gains from gambling. The Court of Appeals for the Ninth Circuit has held that losses and expenses from gambling businesses are limited to the amount of gambling earnings. Boyd v. United States, 762 F.2d 1369, 1372-73 (9th Cir. 1985); Nitzberg v. Commissioner, 580 F.2d 357, 358 (9th Cir. 1978).

The Kents argue that the decisions in Boyd and Nitzberg are incorrect because wagering losses should not be limited for business gamblers. According to the Kents, neither the legislative history of section 165(d) nor the statutory construction of section 165(d) supports its application to business gamblers. The Kents also argue that the Supreme Court case Commissioner v. Groetzinger which recognized gambling as a business requires the Court to reexamine the reach of section 165(d). 480 U.S. 23, 35 (1987). In addition, the

Kents maintain that applying section 165(d) to business gamblers violates Equal Protection.

A. Legislative History

Section 165(d) originally appeared in the Revenue Act of 1934 as section 23(g). The law prior to section 23(g) did not limit deductions for gambling losses when the gambling was legal, while illegal losses could only be taken to the extent of illegal gambling gains. The Report of the House Ways and Means Committee noted that the law prior to section 23(g) created a situation where taxpayers would often report their losses, but not their gains. Under section 23(g), taxpayers also had to limit their losses for legal gambling. According to the Report, the new limitation would require taxpayers to report their gains if they wanted to report their losses. Skeeles v. United States, 95 F. Supp. 242, 247 n.2 (Cl. Ct. 1951) (citing H. R. No. 704, 73rd Cong., 2d Sess., p. 22.)

The Kents position is that the above history shows that the provision was enacted to stop people from creating losses. They reason that only occasional gamblers need to create losses because they have other income to offset. Therefore, section 165(d) should not apply to business gamblers. However, the fact that limiting the ability to create losses was a purpose of Congress in enacting the law does not demonstrate that Congress did not intend the law to apply to professional gamblers. Congress appears to have intended section 23(g) to apply to all gambling losses. In the Revenue Act of 1934, section 23(a) contained the provision allowing the deduction of ordinary business expenses. By adding section 23(g), Congress appears to have been limiting the business deductions of the previous paragraph. Valenti v. Commissioner, 68 T.C.M. (CCH) 838 (1994); Humphrey v. Commis-

sioner, 162 F.2d 853, 855 (5th Cir. 1947) ("All wagers are . . . gathered into a class of their own and dealt with as the paragraph states.").

The Kents state that the above cases which find that all gambling losses should be limited misconstrue the legislative history. They argue that Humphrey contradicts Treasury Department testimony during the 1934 Senate hearings. During the hearings, a senator asked if the Treasury found it necessary to determine if gambling was a taxpayer's business. Humphrey, 162 F.2d at 855 n.1. A treasury official responded by stating, "'You wouldn't need to in this connection, because he could get the deduction as a loss, if the transaction was entered into for a profit, in the event the transaction was legal.'" Id.

The dissent's position in Humphrey was that the Treasury official's answer meant that only gamblers for profit could deduct gambling losses, but those losses would be limited to winnings. Id. (Holmes, J., dissenting). The Kents argue that since the majority rejected the dissent's interpretation, the only other interpretation is that both legal and illegal recreational gamblers could deduct losses up to winnings, but gamblers for profit still could deduct all their losses as ordinary business expenses. However, another case found that the answer taken in context was just a statement of the pre-section 23(g) law. Skeeles v. United States, 95 F. Supp. 242, 246 (Cl. Ct. 1951). These different interpretations demonstrate that the official's meaning can not be gleaned from such a small excerpt. Since the meaning is unclear, it does not support the Kents' argument that Humphrey contradicts the legislative history.

The legislative history does not show that Congress of 1934 expressly considered the issue of professional gamblers. There is no support for the argument that it intended to

exclude business gamblers from the loss limitation provisions. Instead, Congress appeared to have enacted a provision to deal with all gambling losses.

B. Statutory Construction

If the legislative history of a statute is unclear, courts can turn to general rules of statutory construction to determine how a law should be applied. As a general rule, a specific statute controls a general statute. See, e.g., Nitzberg v. Commissioner, 580 F.2d 357, 358 (9th Cir. 1978) (citing United States v. Bates, 429 F.2d 557, 559 (9th Cir. 1970)). In cases considering a conflict between section 162(a) and section 165(d), courts find that section 165(d) is the more specific and thus, controls. The Kents assert that section 162(a) is not more general because it specifically states that it applies to any business. This argument is clearly without merit. Section 162(a) refers to general business losses, while section 165(d) applies only to gambling losses. See id.

C. Commissioner v. Groetzinger

In Commissioner v. Groetzinger, the Supreme Court found that an individual could be in the business of gambling. 480 U.S. 23, 35 (1987). According to the Kents, the Supreme Court has recognized that gambling is an acceptable activity. Therefore, business gamblers should get equal treatment with other businesses, and this Court should reexamine earlier decisions. The Kents position ignores that the acceptability of gambling as a profession was not a determinative factor in the earlier decisions. The courts conceded that the taxpayers were involved in legitimate businesses, but concluded that the gambling losses were still limited to gam-

bling earnings. See, e.g., Offutt v. Commissioner, 16 T.C. 1214, 1215-16 (1951). Cases after Groetzinger have not reached a different conclusions. See Kochevar v. Commissioner, 70 T.C.M. (CCH) 1627 (1995). Therefore, Groetzinger does not support the argument that business gamblers should be allowed to deduct losses in excess of winnings.

D. Equal Protection

The Kents' final argument their gambling losses should not be limited is that section 165(d) violates Equal Protection because its application subjects different kinds of businesses to different treatment. An equal protection requirement has been applied to the federal government through the Due Process Clause of the Fifth Amendment. Bolling v. Sharpe, 347 U.S. 497, 499 (1954). The Supreme Court has held that subjecting a particular class to taxation while not subjecting a different class does not infringe any constitutional limitation. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1937). The government can tax different members of a class differently as long as it has a rational basis. Id.

The Kents acknowledge that the government only needs a rational basis to tax gambling businesses differently, but contends that the law fails the rational basis test in this case. The Kents argue that the government no longer has a rational reason for not allowing excess gambling losses for businesses because the Supreme Court found that professional gambling is acceptable in Groetzinger. A rational reason for a law only requires that there is "any conceivable state of fact which would support it." Id. Public opposition to gambling as morally wrong is still a valid reason for a law even if the public sentiment as lessened. See Valenti v. Commissioner, 68 T.C.M. (CCH) 838 (1994). Also, the government is not

required to prove public opposition to gambling as the Kents suggest.

The Kents also assert that law fails rational basis because limiting gambling losses is not a rational way to achieve the law's purpose. Again, their argument is without merit. The Kents predict that the law will cause more gambling businesses to fail. They do not explain why this demonstrates an irrational method. If the Kents' prediction comes true, the law would have achieved its purpose of discouraging a morally repugnant activity and would be proven rational.

The Kents have shown neither an irrational reason, nor an irrational method. As stated by the Tax Court, "[t]he arguments that section 165(d) violates equal protection as applied to those engaged in the trade or business of gambling borders on the frivolous." Id.

IV. Conclusion

The Kents want this Court to find that business gamblers do not have to limit their losses to their winnings. To reach this conclusion, this Court would have to disregard persuasive authority going back fifty years and Ninth Circuit precedent going back almost twenty years. This Court declines to do so.

IT IS THEREFORE ORDERED that the Kents' Motion for Summary Judgment (#8) is DENIED.

IT IS FURTHER ORDERED that the United States' Cross-Motions for Summary Judgment (#9 and #16) are GRANTED.

DATED: March 23, 1998

/s/
PHILIP M. PRO
United States District Judge